

Iowa Lottery Authority

Performance Report

Performance Results Achieved
Fiscal Year 2006



Introduction

I am pleased to present the Iowa Lottery Authority's performance report for fiscal year 2006 (July 1, 2005, through June 30, 2006). This report contains information about the activities of the Iowa Lottery Authority during the past fiscal year.

The Iowa Lottery achieved record sales in its latest fiscal year and raised nearly \$81 million for state programs. Here are some key financial highlights from fiscal year 2005:

- Lottery sales increased for a fifth straight year. For fiscal year 2006, Lottery sales totaled more than \$339.5 million, which marked the highest sales total for the lottery since its start in 1985. The Lottery's previous sales record of \$210.7 million was set just a year earlier. Overall, sales were up over 61 percent in fiscal year 2006 after a 1 percent increase in fiscal year 2005 and an 11 percent increase in fiscal year 2004.
- Lottery proceeds for state programs were nearly \$81 million for fiscal year 2006, an increase of over 58 percent from the previous year. The Lottery's previous record for proceeds to the state was set in fiscal year 1995, when \$58.2 million was raised for state programs.
- Changes introduced in the Powerball game in August 2005 were reflected in the Lottery's strong 2006 results, with Powerball sales increasing more than 31 percent to \$71.1 million, a record level in Iowa (the previous record of \$65.9 million was set in FY 2004). As a result of the changes in Powerball, jackpots now begin at \$15 million compared to the \$10 million in years past and the prize for matching the first five numbers without the Powerball has doubled to \$200,000.
- Sales of instant-scratch tickets, the first product introduced by the Lottery and always one of its sales leaders, were also up in fiscal year 2006 compared to a year earlier, increasing more than 3 percent to nearly \$106.6 million. That also was a record for instant-scratch sales in Iowa (the previous record of \$103.9 million was set in FY 1995).
- Net revenue from TouchPlay machines totaled over \$121.4 million in fiscal year 2006, compared to \$6.4 million in fiscal year 2005. The TouchPlay program was ended in May 2006.
- Since the Lottery's inception in 1985, more than \$2 billion has been awarded in prizes and more than \$1 billion has been raised for state programs.

Sincerely,

Edward J. Stanek
Chief Executive Officer
Iowa Lottery Authority

Overview of the Iowa Lottery Authority

The Iowa Lottery was established in 1985 and began sales of products on August 22 of that year. The Lottery has always focused on results, and since its inception, has awarded more than \$2 billion in prizes and has raised more than \$1 billion for state programs. The Lottery's mission is to conduct a statewide lottery in a secure, controlled manner so as to maximize net revenue while maintaining the dignity of the state of Iowa and the welfare of its people.

The guiding principles of the Iowa Lottery are:

- Develop and distribute products that are fun and exciting to Iowans;
- Maintain integrity and security in production and delivery of those products while utilizing the highest level of technology available;
- Educate and motivate the public to play Lottery games responsibly;
- Maintain the dignity of the Lottery through truthful, tasteful, and informative advertising;
- Develop an effective employee workforce that is professional, knowledgeable, skilled, and offers maximum service and reliability to retailers and players; and
- Maximize net revenues to the state.

The Lottery is guided by the leadership of Dr. Ed Stanek, Chief Executive Officer, and the five-member Iowa Lottery Board. The Board and the CEO have joint responsibility for hiring and retaining key lottery staff members, for entering into major contracts, procuring the printing of instant and pull-tab tickets, for the purchase or lease of equipment or services essential to the operation of Lottery games, and for the purchase or lease of real estate.

The Lottery operates with approximately 117 employees separated in five divisions: security, finance, operations, sales, and marketing. Approximately 50 employees are assigned to Lottery Headquarters, currently located at 2323 Grand Avenue in Des Moines. These associates design games, draft and administer contracts, oversee ticket printing and security, validate and pay winning tickets, plan marketing, public relations, and promotional efforts, and perform accounting, information technology, and data processing duties. The Lottery also maintains several staff members at a warehouse facility in Ankeny. The remaining employees are sales representatives, regional managers, and support staff who work out of four regional offices located in Storm Lake, Council Bluffs, Cedar Rapids and Mason City.

The Lottery offers three separate product lines: Instant, Pull-tab and On-line. Instant games generally have a scratch-off latex covering that is removed by the player to identify winning tickets. For Pull-tab tickets, players open tabs to reveal whether a prize has been won. On-line games are "numbers" games where computerized tickets are generated from a terminal.

The Lottery's customer market is Iowans age 21 and older. The Lottery designs its products to appeal to a variety of demographics. Different game themes, price points, play action, and prize structures are used to broaden the appeal. The Lottery also identifies the legislative body as a customer market. A legislative program is in place to inform legislators about new games and public service programs. Legislators are shown how the Lottery complies with laws and regulations and are reminded how the Lottery helps the state of Iowa and maintains the dignity and welfare of its people.

Lottery products (Instant, Pull-tab and Lotto tickets) are sold through licensed retail outlets throughout the state. Each outlet carries computer equipment for ticket validation that is linked through an intricate communications network to a central ticket system operated by the Lottery's on-line vendor, Scientific Games. The link to the central system records every transaction on the entire network to ensure the integrity of the system. With the data from the system, the Lottery monitors sales and validations, monitors the movement of inventory, collects accounts receivable, and determines retailer commissions. The network operates seven days a week, for approximately 21 ½ hours a day.

The Lottery has about 2,600 licensed retail outlets, which are visited on a weekly basis by a lottery sales representative. The sales reps make sure that each retailer has an adequate ticket supply, distribute point-of-purchase marketing and informational materials, and provide retailer training.

On July 1, 2003, the Legislature recognized that as an entrepreneurial entity, the Iowa Lottery could operate more efficiently by being freed from the bureaucracy associated with state government and lifted some of its prior constraints by establishing the Iowa Lottery Authority, a public instrumentality of the state. As a result of that change, sales have continued to climb in the fiscal years since then.

In fiscal year 2006, the Iowa Lottery had record sales of \$339.5 million and turned over nearly \$81 million in profits to the state coffers. The Lottery expended \$12.1 million in operations and almost \$7 million in advertising in fiscal year 2006.

The Iowa Lottery discusses three core functions in this report: sales; distribution and resource management; and enforcement and investigation.

Performance Plan Results

CORE FUNCTION

Name: Sales & Distribution

Description: The Lottery distributes lottery products throughout the state in a manner that maximizes revenues and recruits and maintains licensed retail outlets to help achieve this goal.

Why we are doing this: To generate revenues to the General Fund in order to provide financial support for state services.

What we're doing to achieve results: The Lottery strives to maintain an effective sales force, utilizes advertising to build customer awareness, and generates interest in products and specific games via special promotions.

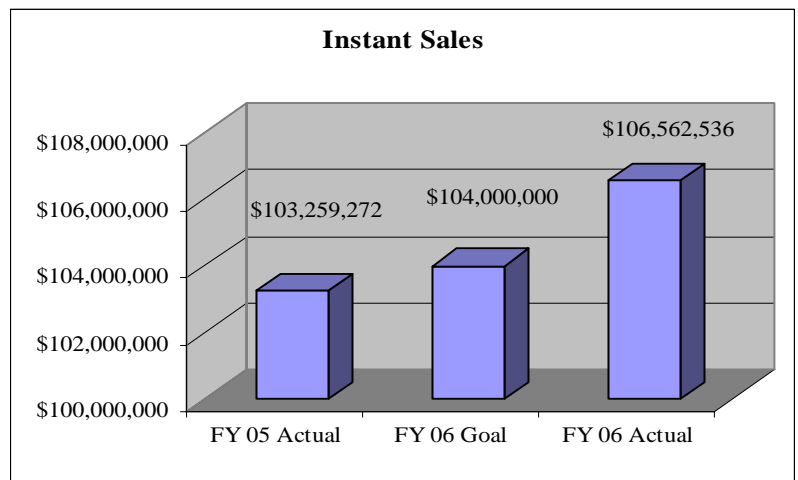
Results

Performance Measure: Sales of instant tickets

Performance Target: \$104.0 million

What was achieved: \$106.6 million

Data Source: Iowa Lottery Authority accounting records

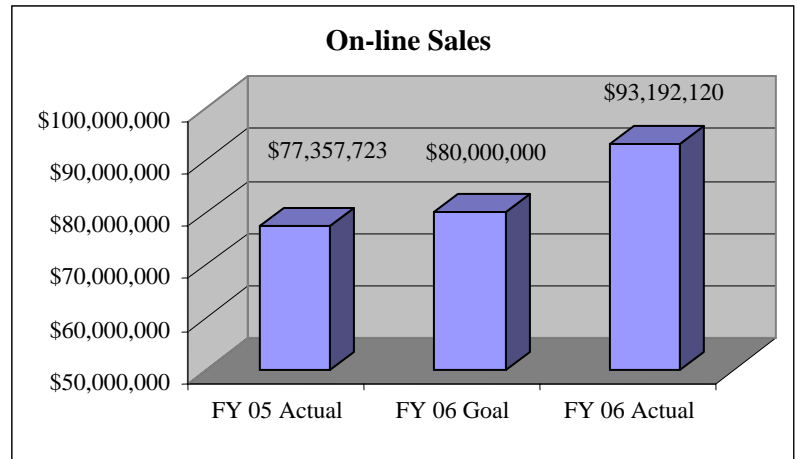


Performance Measure: Sales of on-line game tickets

Performance Target: \$80.0 million

What was achieved: \$93.2 million

Data Source: Iowa Lottery Authority accounting records

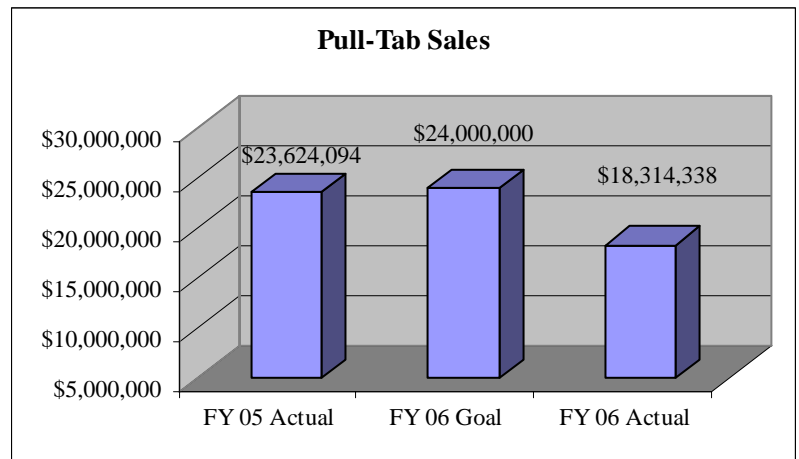


Performance Measure: Sales of pull-tab tickets

Performance Target: \$24.0 million

What was achieved: \$18.3 million

Data Source: Iowa Lottery Authority accounting records

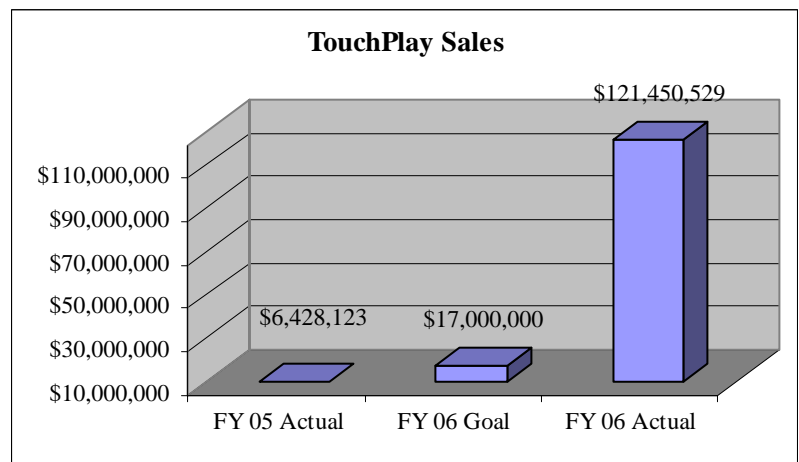


Performance Measure: Net Sales - TouchPlay

Performance Target: \$17 million

What was achieved: \$121.4 million

Data Source: Iowa Lottery Authority accounting records



Data Reliability: The Lottery's central computer system for on-line, instant and pull-tab products, which is linked to every licensed retailer in the state, records every transaction on the entire network in order to ensure the integrity of the system. The data obtained from this network is 100% reliable.

Why We Use These Measures: The Legislature, the governor, and the public use sales data to generally determine how the Lottery is doing. Sales of different products are compared by the Lottery on a yearly basis in order to assess progress.

What Was Achieved: For FY 2006, instant ticket sales exceeded \$106 million, pull-tab sales were \$18.3 million, on-line ticket sales were nearly \$93.2 million and TouchPlay net sales exceeded \$121 million.

Analysis of Results: Overall Lottery sales for fiscal year 2006 were up more than 61 percent, at \$339.5 million, compared to \$210.7 million for fiscal year 2005. TouchPlay revenue grew to over \$121.4 million in fiscal year 2006. Instant-scratch ticket sales, the Lottery's traditional sales leader, increased by more than 3 percent to a record level of nearly \$106.6 million. In addition, sales of Powerball rose more than 31 percent to \$71.1 million, also a record level in Iowa. Pull-tab sales fell from \$23.6 million in fiscal year 2005 to \$18.3 million in fiscal year 2006.

Factors Affecting Results: The Lottery designs its games to appeal to a variety of demographic groups. Lottery sales in future years will be impacted by the discontinuation of the TouchPlay project which ended in May 2006. Research plays a significant role in the success of Lottery products and marketing efforts. A yearly baseline study supplies the Lottery with valuable player information, as well as public perceptions about the Lottery. Focus groups keep us attuned to players' feelings and opinions. Feedback from players and retailers is used to gauge product acceptance.

Resources Used: In FY 2006, the Lottery spent \$12.1 million on administrative expenses, nearly \$7 million on advertising, and had approximately 117 employees on staff. All these resources contributed to the total sales made by the lottery.

Performance Plan Results

CORE FUNCTION

Name: Resource Management

Description: Maintain integrity and security in production and delivery of lottery products while utilizing the highest level of technology available. Also maintain accurate and timely accountings of both incoming revenues and outgoing expenditures.

Why We Do This: The media, the Legislature, and the public closely scrutinize the actions of the Lottery. Because the Lottery's profits are deposited into the General Fund, it is essential to ensure that its resources are managed wisely in order to achieve maximum benefits for the state as a whole.

What We Do To Achieve Results: Internal integrity and security is paramount to the Lottery. Background checks are conducted on all potential employees and suppliers of major procurements before they can become members of the Lottery team. Strict licensing requirements, including background checks, ensure that only reputable retailers sell Lottery products. The Lottery's security division conducts retailer reviews and reports its findings to the Lottery's Board. The sales and validation system integrity is tested daily by an internal control system. All drawings are monitored and verified by an independent auditor. All sales reps are required to balance their ticket inventory on a weekly basis. Periodic performance evaluations and the resulting reports are also a must to ensure that the Lottery's integrity remains intact. The Lottery is subject to annual financial audits by the State Auditor's Office. A major accounting firm conducts an annual performance audit on the Lottery's sales and validation system. Additionally, the Lottery's internal auditor reviews major processes, internal control procedures, and advertising contracts. Post-buy analysis of media plans ensures that advertising has the intended frequency and scope. Reports from all these sources help Lottery management to assess organizational performance and identify areas for improvement in order to ensure that the Lottery's resources are effectively managed.

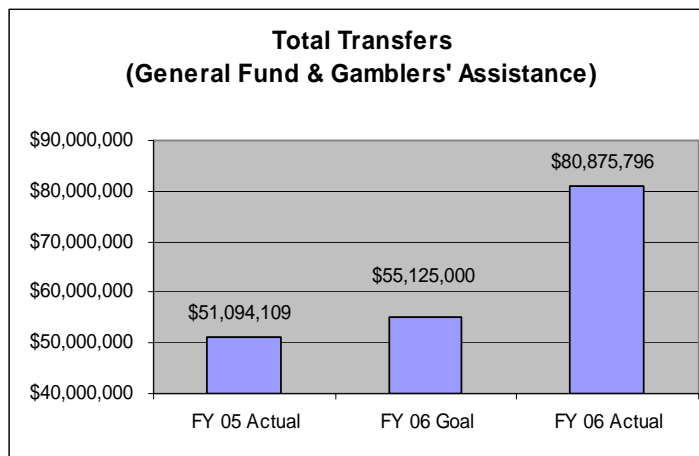
Results

Performance Measure: Total transfers to the state, including the General Fund & Gambler's Assistance Fund

Performance Target: \$55.1 million

What was achieved: \$80.9 million

Data Sources: Iowa Lottery Authority accounting records



Data Reliability: The Lottery's central computer system for on-line, instant and pull-tab products, which is linked to every licensed retailer in the state, records every transaction on the entire network in order to ensure the integrity of the system. The data obtained from this network is 100% reliable.

Why We Use This Measure: Total transfers is the ultimate measure of how well the Lottery is operating because it accounts not only for sales, but also for how well resources are being used. The Lottery must ensure its resources are managed wisely in order to achieve maximum benefits for the state as a whole.

What Was Achieved: The Lottery transferred a total of nearly \$81 million in fiscal year 2006. This total included nearly \$79.2 million in General Fund transfers and over \$1.7 million in transfers to the Gambling Treatment Fund.

Analysis of Results: Although overall sales achieved record levels with increases in Powerball, instant and TouchPlay sales leading the way. Lottery sales and profits to the state both set records in fiscal year 2006.

Factors Affecting Results: Lottery sales for fiscal year 2006 were up a dramatic 61 percent. Instant-scratch tickets, always one of the Lottery's traditional sales leaders, saw a sales increase by more than 3 percent to a record level of \$106.6 million. Powerball sales for the fiscal year were up by over 31 percent to a record level of \$71.1 million. TouchPlay games and Pick 4 also saw sales increases. Hot Lotto, \$100,000 Cash Game, Pick 3 and Pull-tab sales all saw declines.

Resources Used: In FY 2006, the Lottery spent \$12.1 million on administrative expenses, nearly \$7 million on advertising, and had approximately 117 employees on staff. All these resources contributed to the total transfers made by the lottery.

Performance Plan Results

CORE FUNCTION

Name: Enforcement and Investigation

Description: Enhance the safety and well being of the public through the enforcement of state laws and to investigate those incidences where laws may have been violated. Activities include investigating complaints of minors buying tickets and taking action to suspend or revoke licenses where justified.

Why We Do This: To help prevent the sale of Lottery tickets to minors.

What We Do To Achieve Results: The Lottery's security division investigates all complaints of underage persons illegally purchasing lottery tickets and initiates actions to suspend or revoke the licenses of retailers for which the complaints have been substantiated.

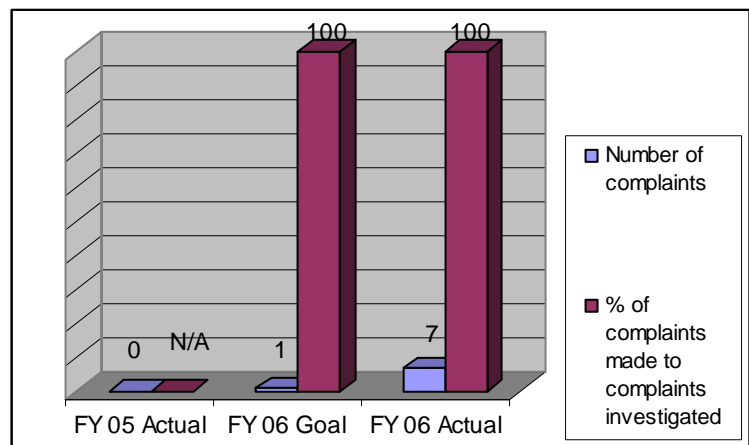
Results

Performance Measure: Percent of complaints filed to complaints investigated

Performance Target: 100%

What was achieved: 100%

Data Sources: Iowa Lottery Authority security records



Data Reliability: All complaints are sent to a central point of contact within the Lottery's security department, the investigative supervisor. The supervisor ensures that all complaints are assigned for investigation, monitors the progress of each investigation and makes recommendations to the Vice-President of Security, as appropriate, to suspend or revoke licenses. The data obtained is 100% reliable.

Why We Use This Measure: Iowa Code 99G.30 requires that "a ticket or share shall not be sold to a person who has not reached the age of twenty-one." The Lottery employs continued vigilance to prevent sales to minors by investigating 100% of all complaints of minors buying tickets and taking action to suspend or revoke licenses where justified.

What Was Achieved: During fiscal year 2006, there were a total of 7 complaints of underage persons illegally buying lottery games. After investigations by the Lottery and Division of Criminal Investigation, 2 complaints resulted in license suspension. The remaining 5 complaints were not substantiated.

Analysis of Results: The lottery has approximately 2,600 licensed retail outlets that sell lottery tickets for its on-line, instant-scratch and pull-tab tickets. In addition, during fiscal year 2006, the Lottery had approximately 2,800 licensed TouchPlay businesses with approximately 5,600 machines. The 2 substantiated complaints represent less than 0.1% of the Lottery's retailers.

Factors Affecting Results: The lottery licensed a number of retailers during fiscal year 2006. Despite training on the prevention of underage sales to persons under age 21, there were two substantiated complaints that resulted in the suspension of two retailer licenses.

Resources Used: In addition to other duties, the Lottery's three investigators, one investigative supervisor and VP of Security were responsible for investigating complaints of minors purchasing Lottery tickets.

Resource Reallocations

With the end of the TouchPlay project in May 2006, the Lottery adjusted its staffing needs. The Lottery terminated the employment of two validation staffers, the TouchPlay testing coordinator filled a vacancy in the Lottery's accounting department and a TouchPlay inspector filled a vacancy in the sales staff. Four other staffers who had been involved in the administration and inspection of the TouchPlay project were reassigned to the Lottery's sales department.

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Iowa Lottery Board Members

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Elaine Baxter, Burlington
Mary Junge, Cedar Rapids
Mike Klappholz, Cedar Rapids
Michael L. McCoy, West Des Moines

Key Iowa Lottery Staff

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Harry Braafhart, Vice-President of Security
Joe Hrdlicka, Vice-President of Marketing
Larry Loss, Vice-President of Sales
Mary Neubauer, Vice-President of External Relations
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